CITY OF HAYWARD
AGENDA REPORT

AGENDA DATE 11/24/98
AGENDA ITEM 4
WORK SESSION ITEM

TO: Mayor and City Council

FROM: Director of Finance and Internal Services

SUBJECT: Annual Investment Report, Revisions to Statement of Investment Policy and Delegation of Investment Authority

RECOMMENDATION:

It is recommended that the City Council 1) receive the Annual Report on Investment Program and Activity for the Fiscal Year Ending June 30, 1998, 2) affirm the Statement of Investment policy, and 3) renew the delegation of authority to make investments to the Director of Finance or his or her designee.

BACKGROUND/DISCUSSION:

The City's Statement of Investment Policy requires that staff submit to the City Council an annual report on the City's investment program and investment activity; further, any changes recommended in the City's Statement of Investment Policy are submitted to the City Council at this time. In addition, the state statutes which govern investment activity require the City Council to annually reaffirm the Statement of Investment Policy, regardless of whether any changes are recommended, and to annually confirm the delegation of investment authority.

Attached for Council's review is the Annual Report on Investment Program and Activity for the year ended June 30, 1998. Upon recommendation of the Investment Advisory Committee, no changes to the Statement of Investment Policy are recommended

The Annual Report on Investments

The following is a brief review of the report noting some of the key statistics and achievements for the year.

The year 1997-98 was characterized by positive economic events. On the economic front, this year continued the pattern of moderate growth and subdued inflation which characterized the preceding year. The economy grew approximately 3.1% during the year, with the rate of growth strongest during the 1st and 3rd quarters of the fiscal year, spurred primarily by vigorous consumer spending.

The monthly average of the rates of thirteen and twenty six week Treasury Bills which serves as the benchmark against which portfolio performance is measured moved in a relatively narrow range during the year. Charts C & F illustrate this. The Target Rate at the beginning of the fiscal year was 5.57%, rising unevenly to its high of 5.70% in December, and then falling immediately to its yearly low of 5.52% in January and averaging approximately 5.56% for the second half of the fiscal year. This represents a spread from high to low of only 18 basis points for the year, compared to a range of 29 basis points in 1996-97, and 59 basis points in the preceding year. This is indicative of the remarkable level of interest rate stability enjoyed during the past year. The Effective Yield of the portfolio was similarly stable, varying only 24 basis points during the reporting period. It began the year at 5.76%, reached a low of 5.63% in December and finished the year at 5.74%.

The following comparative statistics display the result of the events of the year on the City's portfolio in comparison to previous years:

	1994-95	1995-96	1996-97	1997-98
		Thousands (000)		
Average portfolio value	$62,261	$62,008	$65,998	$71,132
Annual portfolio earnings	3,453	3,548	3,742	4,119
Annual portfolio yield	5.55%	5.77%	5.67%	5.79%

Available cash for investment rose in 1997-98, increasing by $5,134,000 or 7.8%. This compares to an increase of 6.4% last year and a decline of 0.4% the year before. Overall, this is indicative of balanced operating budgets and use of bond proceeds rather than current revenue to finance improvements, as well as the continued effect of a healthy local economy. Portfolio yield increased to 5.79% and portfolio earnings increased approximately $377,000 or 10.07% over the prior year. This increase is attributable to the larger average portfolio value and consequent increase in funds available for investment as well as the higher yield.

When expressed as a percentage of the performance target (the average of the rates of thirteen and twenty six-week Treasury Bills plus 50 basis points), portfolio performance averaged 103.79% of the target for the year comparing favorably to last year's 100.49%. The performance rate at the beginning of the year was 103.41%, falling below the target threshold to 98.77% of the target during December. By year-end, performance was 103.24% of the target.

During 1997-98 Investment Policy standards for quality continued to be exceeded. Nearly 95% of all dollars invested during 1997-98 were at the highest possible rating, AAA. The remaining 5% of investments, some $2 million, were made at the highest possible double A level, AA1.

In other areas of performance, liquidity needs continue to be met as investments in L.A.I.F. are immediately accessible, and other investments mature during the year. The portfolio is diversified in accordance with Policy requirements and sound practice.

The investment strategy for 1998-99 anticipates that interest rates will generally trend downward. At the time of this writing, the Federal Reserve (the Fed) has recently acted to reduce adjustable interest rates 25 basis points.

Consequently, the City will take advantage of the higher interest rates available in the state Local Agency Investment Fund (L.A.I.F.) and not actively seek to reduce the amount invested in the state pool unless warranted by available market interest rates. This strategy recognizes that portfolio yield will begin to decline as existing, higher yielding securities mature and are replaced with lower yielding securities or by investments in L.A.I.F. which will also offer lower yields as its investments track the overall decline in market rates. For a time however, L.A.I.F. rates will be substantially higher than longer-term rates. As rate variations occur we will take advantage of them and changes in the yield curve with investments that offer the most favorable increment of yield, within the constraints set by the Investment Policy. Such purchases will be made in consideration of the diversification and cash flow requirements of the portfolio, and quality will continue to be emphasized. L.A.I.F. will continue to be used to maintain adequate liquidity as well as additional yield.

Revisions to Statement of Investment Policy

No changes or revisions to the Statement of Investment Policy are required or recommended at this time.

Status of Committee Expansion

Last year the Policy was amended to provide for the appointment of an additional member of the Advisory Committee from outside of the City's employment "family". This appointment would by made by the City Manager from a member of the financial community. Ideally, such a member would reside or work in Hayward and possess knowledge and expertise concerning the economy, the activities of the Federal Reserve, and in private sector investment practices. Efforts have been made to recruit the new member but this has proved to be a difficult task since the most qualified individuals are those whose time is the most consumed with other commitments. As of this writing, recruitment efforts are continuing.

Submitted by:

Perry H. Carter

Perry H. Carter
Director of Finance and Internal Services

Recommended by:

Jesús Armas

Jesús Armas
City Manager

Attachments: A: Annual Report on Investment Program and Activity
B: Statement of Investment Policy

Attachment A

ANNUAL REPORT

ON

INVESTMENT PROGRAM AND ACTIVITY

For the Fiscal Year Ending

June 30, 1998

Department of Finance

Date: September 11, 1998

I. INTRODUCTION

This report is prepared annually in compliance with the Investment Policy of the City of Hayward and the requirements of the State of California. The purpose of this report is to apprise the members of the City Council, as well as interested citizens, of the performance, composition, quality, diversity and liquidity of the investment portfolio of the City during the preceding fiscal year. Additionally, significant national political and economic events which have influenced the bond market during this period are discussed so that the performance of the portfolio may be viewed in context. This report also provides an opportunity for the City Council to conduct its review, and annually adopt the Statement of Investment Policy in accordance with state requirements, and to amend the policy as required to meet local needs or comply with legal requirements.

II. OVERVIEW OF 1997-98

The year 1997-98 was characterized by positive economic events. On the economic front, this year continued the pattern of moderate growth and subdued inflation which characterized the preceding year. The stock market continued to perform favorably, with the Dow Jones Industrial Average increasing approximately 12.5% during the fiscal year. This is respectable performance although it pales in comparison to the 40% increase of the prior year. The continued buoyant performance of the stock market was attributable to a number of factors, not the least of which was the continued stable, noninflationary growth of the economy. Inflation continues to be remarkably subdued, particularly in view of the fact that the current business expansion is several years old. Specifically, the all urban Consumer Price Index increased only 1.7%, compared to 2.3% last year; and Producer Prices for all commodities actually decreased 1.9%, largely as a result of low prices for energy and raw materials. The economy grew approximately 3.1% during the year, with the rate of growth strongest during the 1st and 3rd quarters of the fiscal year, spurred primarily by vigorous consumer spending. By the last quarter of the year growth had begun to slow however, reflecting the impact of the General Motors strike as well as slowing in trade sensitive industries as a consequence of increasing global economic turmoil. Last year's report indicated that the prospect of inflation would likely be the primary focus of the Federal Reserve and financial markets during 1997-98. This was the case for most of the year as the economy continued to grow and unemployment averaged only 4.6% for the year. Decreasing commodity and energy prices, together with improvements in productivity kept inflation in check and as a consequence, the Federal Reserve Board did not act to adjust interest rates during the year. However, Board members did not miss any opportunity to warn the markets of their inclination to respond to any signs of inflation. These words were often sufficient to induce financial markets to adjust bond prices in response, effectively changing interest rates without direct Fed action.

As a result, the monthly average of the rates of thirteen and twenty six week Treasury Bills which serves as the benchmark against which portfolio performance is measured moved in a relatively narrow range during the year. Charts C & F illustrate this. The Target Rate at the beginning of the fiscal year was 5.57%, rising unevenly to its high of 5.70% in December, and then falling immediately to its yearly low of 5.52% in January and averaging approximately 5.56% for the second half of the fiscal year. This represents a spread from high to low of only 18 basis points for the year, compared to a range of 29 basis points in 1996-97, and 59 basis points in the preceding year. This is indicative of the remarkable level of interest rate stability enjoyed during the past year. The Effective Yield of the portfolio was similarly stable, varying only 24 basis points during the reporting period. It began the year at 5.76%, reached a low of 5.63% in December and finished the year at 5.74%.

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When expressed as a percentage of the performance target (the average of the rates of thirteen and twenty six week Treasury Bills plus 50 basis points), portfolio performance averaged 103.79% of the target for the year. comparing favorably to last year's 100.49%. The performance rate at the beginning of the year was 103.41%, falling below the target threshold to 98.77% of the target during December primarily as a result of the need to maintain sufficient cash balances in non interest bearing bank accounts to fund accounts payable and outstanding payroll during the period City offices were closed following the relocation of City Hall. By year end, performance was 103.24% of the target.

III. ACHIEVEMENTS IN 1997-98

During 1997-98, accomplishments such as the following were achieved.

A. Exceeded Statement of Investment Policy standards for investment quality.

Moody's and Standard & Poor's and other rating agencies do not rate the Local Agency Investment Fund, the State investment pool in which the City has deposits. Yet, all investments in the City portfolio except for deposits in L.A.I.F. meet or exceed ratings required by State law and/or the City's Statement of Investment Policy. Chart E, attached to this report provides information relating to the rating of all securities purchased during 1997-98. This chart clearly shows that 94.9% of the dollars invested were done so at the highest rating, AAA. They are rated as prime quality though there is no legal or policy requirement that mandates purchases at such quality levels.

An additional incentive to purchase investments at the highest quality level was the fact that the difference in yield, known as "spread" between quality levels has been very small. That is, investors are not provided with a significantly higher yield as compensation for lower levels of quality. In such a context, prudence indicates that the higher quality investments should be purchased, as little additional yield would be gained by purchasing lower quality investments. As a consequence, only 5.1% of 1997-98 investments, some $2,000,000, were made at any level other than the highest possible, and this investment was made at the highest double A level, AA_1.

The Statement of Investment Policy allows for investments of up to two years at the lowest single A level. The fact that this year's investments have exceeded this requirement by a substantial margin clearly demonstrates the commitment to safety required by the Investment Policy.

To facilitate review of the quality of the City's portfolio, the monthly Investment Portfolio Report includes a portfolio detail report which displays the rating of each security. These ratings are revisited monthly when portfolio prices are updated. Any rating changes are detailed in the report if they occur.

B. Enjoyed a trouble free audit of 1997-98 investment activity

Over the last eight years the City's data on investment activity has been organized to make auditing of Treasury more convenient for the auditors. This effort was successful again in 1997-98 for the audit of the prior year.

C. Prepared revisions to the Statement of Investment Policy

Following the previous year's comprehensive revisions to the California Government Code regulations governing the investment practices of local agencies, the legislature made only minor changes in the code. In response to this change, the Statement of Investment Policy was amended to clarify the City Council's delegation to the Director of Finance of the authority to invest public funds. Further changes were made upon recommendation of the City's auditor. These changes were focused upon ensuring internal consistency within the Policy and were not substantive in nature. The final and most significant change incorporated in the Policy related to the composition of the Investment Advisory Committee. Specifically, this amended the Policy to provide for the appointment of an additional member of the Advisory Committee from outside of the City's employment "family". This appointment would by made by the City Manager from a member of the financial community. Efforts have been made to recruit the new member but this has proved to be a difficult task since the most qualified individuals are those whose time is the most consumed with other commitments. As of this writing, recruitment efforts are continuing.

City Council adopted these changes and amended the Statement of Investment Policy at the City Council meeting of October 28, 1997.

IV. PERFORMANCE INDICATORS

A. Safety and risk tolerance

As indicated above, the Statement of Investment Policy's quality standards were far exceeded in 1997-98. There were no exceptions to investment quality or other standards set by policy. This will be apparent from the following discussion of the various categories of City investment and of practices required in the administration of the investment program.

Negotiable certificates of deposit (unlike collateralized CDs, these trade on the open market and are rated on the credit worthiness of issuers, not on collateralization): One Negotiable CD with a par value of $2,000,000 was purchased in 1997-98, and the rating of this security was at the highest double A level, AA_1, although the Policy allows for purchase of this type of investment at the single A level for a two-year maturity, or less. This investment had a one year maturity. It was the only purchase not made at the triple A level during the year.

Collateralized certificates of deposit have been de-emphasized because ratings of most savings and loan issuers do not meet policy standards. Collateralized CDs of well-rated institutions have not been competitive.

Bankers acceptances are securities based on sales of products which serve as security for the transaction with underwriting of the transaction also being provided by the issuing bank. Because the Policy authorizes a maximum maturity of 270 days for Acceptances, these instruments were not competitive with rates available in the state investment pool, L.A.I.F.. As a consequence, no Acceptances were purchased during 1997-98.

Commercial paper (corporate I.O.U.s of short duration): Though the City always has met the A1/P1 requirement, this security was not bought in 1997-98. Commercial paper simply was not competitive.

Medium term notes (MTNs), for City purposes, differ from negotiable certificates of deposit only by being issued by corporations or bank holding companies, not banks, and by having a bond method of interest calculation which is different than negotiable CD interest calculation. The policy standard for MTNs is the same as for negotiable CDs. Of the $6 million of MTNs purchased, all exceeded the minimum policy requirement of single A, being rated AAA, a highest rating category possible.

Repurchase agreements are collateralized securities which are sold back to the seller on prearranged terms. No use was made of this category of security because "repos" were uncompetitive in 1997-98.

Asset backed securities (ABS) is a subcategory of medium term notes (MTN) which the State made a separate category to override the 30%-of-portfolio ceiling on MTNs. 20% in ABS can be bought under State law in addition to the 30% in MTNs, though City policy permits only 40% of the portfolio in the two security categories. ABS are the collateralized form of MTNs (see the definition in the Glossary of this report). Though State law permits investments in AA-rated asset backed notes, the City invests only in AAA-rated notes. Four of these securities having an aggregate par value of $9,5 million and a weighted average maturity of 1.44 years were purchased during 1997-98. All of these securities are AAA rated.

Remaining investments, totaling $21.75 million were in federal agency securities, which are regarded as more secure than AAA, having in the case of the agency securities purchased, the implied guarantee of the United States.

In summary, staff has put a premium on investment safety. However, buying higher quality than necessary is not the only method used to reduce investment risk. Diversification, as discussed in section IIIB below, also reduces risk by spreading it over several types of investment and over many investment sources of excellent quality.

Practices required by the Policy: The Statement of Investment Policy's requirements were scrupulously observed with respect to the following:

1. Only qualified investment institutions were dealt with.

2. All transactions were executed on a delivery-versus-payment basis. This means that the City does not pay for securities until its title to them is confirmed.

3. Competitive bidding by at least three bidders was the standard method of security procurement, and all bidders were pre-qualified by agreement to comply with

the City policies. Furthermore, no addition to the bidders' list is made without the concurrence of the Investment Advisory Committee.

4. Investment practices followed the written authorizations, controls and procedures initially developed in 1985-86, as revised by subsequent changes to the Statement of Investment Policy, all as previously approved by the City Council. Another safety consideration is investment safekeeping. All investment instruments are secured through third party custody and the safekeeping procedures of Sanwa Bank.

B. Diversification

Risk is diluted by diversifying types of investments, diversifying sources of investments, and correlating investment maturities with dates of cash needs.

The City uses a computerized cash budget which plots expenditure requirements and income delivery for the entire year. Staff correlates investment maturities with cash need dates as a matter of routine. Charts A and B (attached) respectively detail diversification by investment type and investment maturity.

At year's end, the portfolio par values for the various types of investments were as follows: $2,000,000 (2.6%) in negotiable CD's, $9,500,000 (12.2%) in asset backed notes, $15,500,000 (19.8%) in medium term notes, $25,392,857 (33.8%) in Treasury and federal agency notes, $23,350,000 (29.9%) in the state's Local Agency Investment Fund (L.A.I.F), and $1,347,763 (1.7%) on deposit with the bank. The only categories over which the portfolio was not diversified were those that were performing so badly that it would be irresponsible to buy therein.

The portfolio has diversification of maturities and diversification of security types, in addition, L.A.I.F. spreads risk over more investment types and infinitely more investment sources than a City portfolio could utilize on its own. Moving money into L.A.I.F. improves diversification vastly. Hence, purchase of longer investments was done when improved earnings justified the longer maturities. Staff avoided pulling funds from L.A.I.F. in response to the illusion of diversifying. We moved money out of L.A.I.F. when yields rose to a level which justified the move to the longer maturities available outside L.A.I.F.

C. Liquidity

A portfolio has the appropriate level of liquidity if needed portions of it can be converted into cash to meet obligations and to take advantage of market conditions. Of these factors, the need to meet obligations is the most critical. To ensure adequate cash is available the City monitors its cash position daily, satisfying its obligations and investing the remaining cash. L.A.I.F. is the investment of choice for this purpose. L.A.I.F. offers the City overnight liquidity at rates which are usually equivalent to those of six-month investments. Additionally, L.A.I.F. is used as an investment alternative to other, longer term securities. As a consequence, at year end the investment in L.A.I.F provided sufficient liquidity to more than cover foreseeable shortfalls in cash resulting from the normal variability of our many revenue sources. Additionally, there is nothing in the portfolio that cannot be sold immediately if the need arose, although it generally is our practice to hold investments until they mature. However, maturities alone will provide big contributions to liquidity. By December 30, $12,250,000 various securities will mature and in the second half of 1998-9 an additional $16 million will reach their maturity. A total of more than $28 million in maturities on top of the $23,350,000 in L.A.I.F. demonstrates a high level of liquidity.

The Statement of Investment Policy sets three major maturity constraints to insure liquidity:

1. The City shall not invest in instruments whose maturities exceed four years at the time of purchase. State law allows five year maturities, but City policy is more demanding than State law in several important respects.

2. No more than 40% of the portfolio shall be invested beyond twelve months.

3. The average maturity of portfolio investments shall not exceed 400 calendar days.

During 1997-98 all policy constraints were met except that during the months of July and October more than 40% of the portfolio was invested beyond twelve months. The specific overages were 2.7% and 1.45% respectively. The overage in July was for July 31st only, as a new purchase with a two year maturity settled on the last day of the month. This policy exception was cured in August as $3 million moved to the 270-359 day maturity category. October's policy exception arose from a combination of two factors. The first was the decrease in the size of the portfolio and the second was the purchase of a new security with a par value of $2 million and a maturity of 365 days. The policy uses the words "beyond twelve months" but the monthly report uses the financial convention of defining a year as twelve months of 30 days each, for a total "year" of 360 days. As a result, although the newly purchased security had a one calendar year maturity, the 360 day per year financial convention used to define "beyond one year" in establishing maturity categories caused this security to be itemized in the next maturity category "360-719" days. The policy exception occurred as a result. This exception was cured in November as $4 million, including the newly purchased security, moved to the 270-359 maturity days category.

To ensure such exceptions do not occur in the future, trial month-ending categorizations of maturities will be performed when purchases of securities of more than 360 days are contemplated.

D. Yield

The Statement of Investment Policy says that portfolio is to be managed with an emphasis upon most primarily upon safety, in consideration of liquidity needs, and then to consider yield. As can be seen in the previous sections, this policy direction has been followed, as demonstrated by the high quality, diversity, and liquidity of the portfolio. The need to maintain quality, diversity, and liquidity constrain the ability to maximize yield. Even so, portfolio performance exceeded the policy guideline during 1997-98.

Yield is the percentage of annual return on investment. As noted at the beginning of this report, yield increased to 5.79% in 1997-98 from the 5.67% recorded in 1996-97. As a result of the increase in the total value of the portfolio, as well as the increased in yield noted here, annual portfolio earnings totaled approximately $4,118,500, representing an increase of $376,500 from 1996-97.

A stable economy as evidenced by the continued moderate growth and low inflation even under conditions of near full employment, induced the Federal Reserve to remain on the sidelines during 1997-98. Rate interventions by the Federal Reserve were limited to public pronouncements regarding the Fed's continued vigilance for any signs of inflation. The Fed's inactivity is demonstrated by the narrow variance in the Policy Target Yield (an average of 13 and 26 week Treasury Bills) which began the year at 5.57%, reached a high of 5.70% in December, promptly fell back to 5.52% in January, and averaged 5.56% for the last six months of the year, finishing the year at this level, 5.56%, in June. This is only 2 basis points less than the 5.58% average for the entire year. Portfolio performance as measured by the Portfolio Effective Rate remained relatively consistent during the year. If the month of December, which varies for an untypical reason is excluded, portfolio yield varied only 13 basis points in 1997-8, from a high of 5.87 in November to the year ending low of 5.74

Chart C indicates that, with the exception of December, portfolio performance exceeded the performance target during the entire fiscal year. Peak portfolio performance of 106.16% of target occurred twice, during the months of October and January. December's performance was the low point of the year, failing to reach the performance target in achieving a level of only 98.77% of target. This performance results from a rather untypical occurrence associated with closure of City offices and is discussed elsewhere in this report. Otherwise, performance remained remarkably consistent for the year, reflective of both stable market rates and portfolio yield. The average of the monthly portfolio rates exceed the target at 103.79% of target for the year. This compares to a level of 100.49% recorded last year. It is important to note however, that the performance level is largely determined by the movement of market interest rates. That is, in a period of rapidly falling rates performance will typically exceed the target, as portfolio holdings would have been purchased in earlier periods of higher rates and would therefore, yield in the aggregate more than the current target. As these holdings mature new purchases are made at the lower prevailing rates, with portfolio yield falling and performance approximating the target. Conversely, in periods of rapidly rising rates, portfolio performance would typically trail the target, until the relatively lower yielding holdings matured. During 1997-98, the market moved only in a narrow range, and by extending maturities and diversifying into various higher yielding types of securities, it proved simple to exceed the target without compromising the quality standards of the Investment Policy

V. THE INVESTMENT ADVISORY COMMITTEE

The Investment Advisory Committee has met with Finance staff responsible for investment every quarter for more than ten years. The purpose of the meetings is review of investment strategy, approval of new investment sources, discussion of economic developments, monitoring of investment activity and consideration of proposed changes to investment practices and to the Statement of Investment Policy. The result has been safe investment, improved investment standards, improved investment quality and maintenance of an invaluable sounding board for staff concerns about the economy, the direction of interest rates, downrating of well-rated issuers of securities and a variety of other subjects related to the treasury operation.

The Advisory Committee consists of the Assistant City Manager (the Chairman), the City Attorney (represented by the Assistant City Attorney), Professor Zock of California State University, Hayward, and two department heads appointed by the City Manager. Appointees currently are the City Clerk and the Public Works Director. During 1997-98, the City Council authorized appointment of an additional Committee member, one who would be a representative of the City's financial community. As discussed earlier in this report, recruitment efforts for this additional appointment are continuing.

Professor Zock's contribution to the Committee again deserves particular thanks. His economic and financial expertise have been invaluable to maintenance of prudent, effective investment, and his insights and humor make meetings a pleasure to attend.

VI. INVESTMENT STRATEGY FOR 1997-98

The investment strategy for 1997-98 anticipates that the Federal Reserve Board's focus will likely be on the impact of turmoil in foreign economies upon the economy of the United States. At the time of this writing, the Federal Reserve (the Fed) has recently acted to reduce adjust interest rates 25 basis points, and bond market participants believe the Fed will further reduce interest rates, in steps, between now and early spring. As a consequence, interest rates have fallen substantially since the end of June. Specifically, the target rate has fallen eleven basis points from the fiscal year ending level and will probably fall a further twenty basis points when September's target is calculated. The decline in interest rates anticipates a slowdown in the economy resulting from the fall off of foreign demand for goods exported by the United States and a flood of low cost imports, with consequent slowing of domestic manufacturing. Additionally, interest rates have been pushed down by high demand resulting from foreign investors seeking the perceived safety and stability of United States Treasury securities in response to a weakening of their domestic economies and currencies. This high demand, combined with reduced supply of bonds since the Treasury no longer has the need to finance a large deficit, has driven the price of Treasury securities up with their yields, which move inversely to prices, falling. Compounding the situation is uncertainty surrounding the stock market. Corporate profits are expected to fall as foreign sales weaken, with consequent reductions in production, domestic employment, and hence, lower sales by other firms not directly involved in foreign markets. The economic picture is clouded further by other factors which are indicative of a healthy domestic economy, and which, in the absence of the international factors discussed above would argue for higher interest rates. These include employment at near record levels, affordable mortgages and incentives to increase household wealth via debt refinancing, the stock market which remains near its record highs despite the recent downturn, and continued consumer confidence and consequent spending.

The investment strategy assumes that rates will generally trend downward and will be volatile. We will take advantage of the higher interest rates available in the state Local Agency Investment Fund (L.A.I.F.) and not actively seek to reduce the amount invested in the state pool unless warranted by available market interest rates. This strategy recognizes that portfolio yield will begin to decline as existing, higher yielding securities mature and are replaced with lower yielding securities or by investments in L.A.I.F. which will also offer lower yields as its investments track the overall decline in market rates. For a time however, L.A.I.F. rates will be substantially higher than longer term rates. As rate variations occur we will take advantage of them and changes in the yield curve with investments that offer the most favorable increment of yield, within the constraints set by the Investment Policy. Such purchases will be made in consideration of the diversification and cash flow requirements of the portfolio, and quality will continue to be emphasized. L.A.I.F. will continue to be used to maintain adequate liquidity as well as additional yield.

Report prepared by:

Ralph Costa
Purchasing and Services Manager

Approved by:

Perry H. Carter

Perry H. Carter
Director of Finance

CHART B

WEIGHTED PERCENT OF PORTFOLIO MATURATION BY MONTH

	Average Maturity Days	Months to Maturity				
		0-1	1-6	6-9	9-12	12 +
Jul 1997 *	274	31.62%	13.55%	9.27%	2.85%	42.71%
Aug	280	27.63%	15.20%	7.98%	10.14%	39.05%
Sept	257	33.07%	15.79%	5.05%	8.65%	37.44%
Oct **	249	32.59%	15.57%	2.97%	7.42%	41.45%
Nov	238	29.83%	16.21%	9.27%	7.71%	36.98%
Dec	214	37.54%	12.28%	9.76%	10.82%	29.59%
Jan 1998	189	40.41%	10.60%	12.35%	9.15%	27.49%
Feb	211	41.74%	10.61%	9.54%	15.52%	22.59%
Mar	228	39.46%	12.23%	10.46%	16.92%	20.93%
Apr	268	34.95%	13.90%	7.09%	14.37%	29.69%
May	266	35.16%	13.85%	14.14%	7.26%	29.60%
Jun	266	31.68%	15.68%	18.09%	2.55%	32.00%
INVESTMENT POLICY LIMITS	400					40.00%

* The Investment Policy provided that no more than 40% of the portfolio may be invested beyond twelve months. During July, 42.71% was invested beyond twelve months, exceeding the policy limitation by 2.71%. This policy exception cured itself during August as securities with a par value of $3 million moved to the 270-359 day category from the 360-719 day category.

** During October, 41.45% was invested beyond twelve months, exceeding the policy limitation by 1.45%. This policy exception cured itself during November as securities with a par value of $4 million moved to the 270-359 day category from the 360-719 day category.

CHART C

YIELD PERFORMANCE RATE BY MONTH

	Investment Policy Target Yield	Actual Yield	Performance Rate *
July 1997	5.57%	5.76%	103.41%
August	5.67%	5.84%	103.00%
September	5.58%	5.76%	103.23%
October	5.52%	5.86%	106.16%
November	5.60%	5.87%	104.82%
December	5.70%	5.63%	98.77%
January 1998	5.52%	5.86%	106.16%
February	5.59%	5.78%	103.40%
March	5.53%	5.78%	104.52%
April	5.54%	5.80%	104.69%
May	5.59%	5.82%	104.11%
June	5.56%	5.74%	103.24%
AVERAGE	5.58%	5.79%	103.79%

* The performance percentage reflects how much better or worse the actual portfolio yield was in relation to the portfolio target yield. Our average performance percentage for 1996-97 was 100.49%, although this had fallen to 98.26% by the end of the year. This year it is 103.79%, starting at 103.41% in July, and maintaining a relatively consistent level of performance, except for December, when portfolio performance fell as a consequence of a large year-ending uninvested balance in the City's bank account. The large balance was an anomaly associated with the occurrance of a pay period simultaneous with the relocation of City offices and consequent computer down time.

CHART D

PAR VALUE, COST, YIELD, AND MATURITY OF FUNDS INVESTED BY MONTH AND QUARTER

	July	August	September	First Quarter Average	October	November	December	Second Quarter Average
Par Value (000's)	70,199	67,759	69,032	68,997	67,511	64,801	69,198	67,170
Total Cost (000's)	70,046	67,659	68,932	68,879	67,364	64,707	69,111	67,061
Average Yield	5.76%	5.84%	5.76%	5.79%	5.86%	5.87%	5.63%	5.79%
Average Maturity	274	280	257	270	249	238	214	234

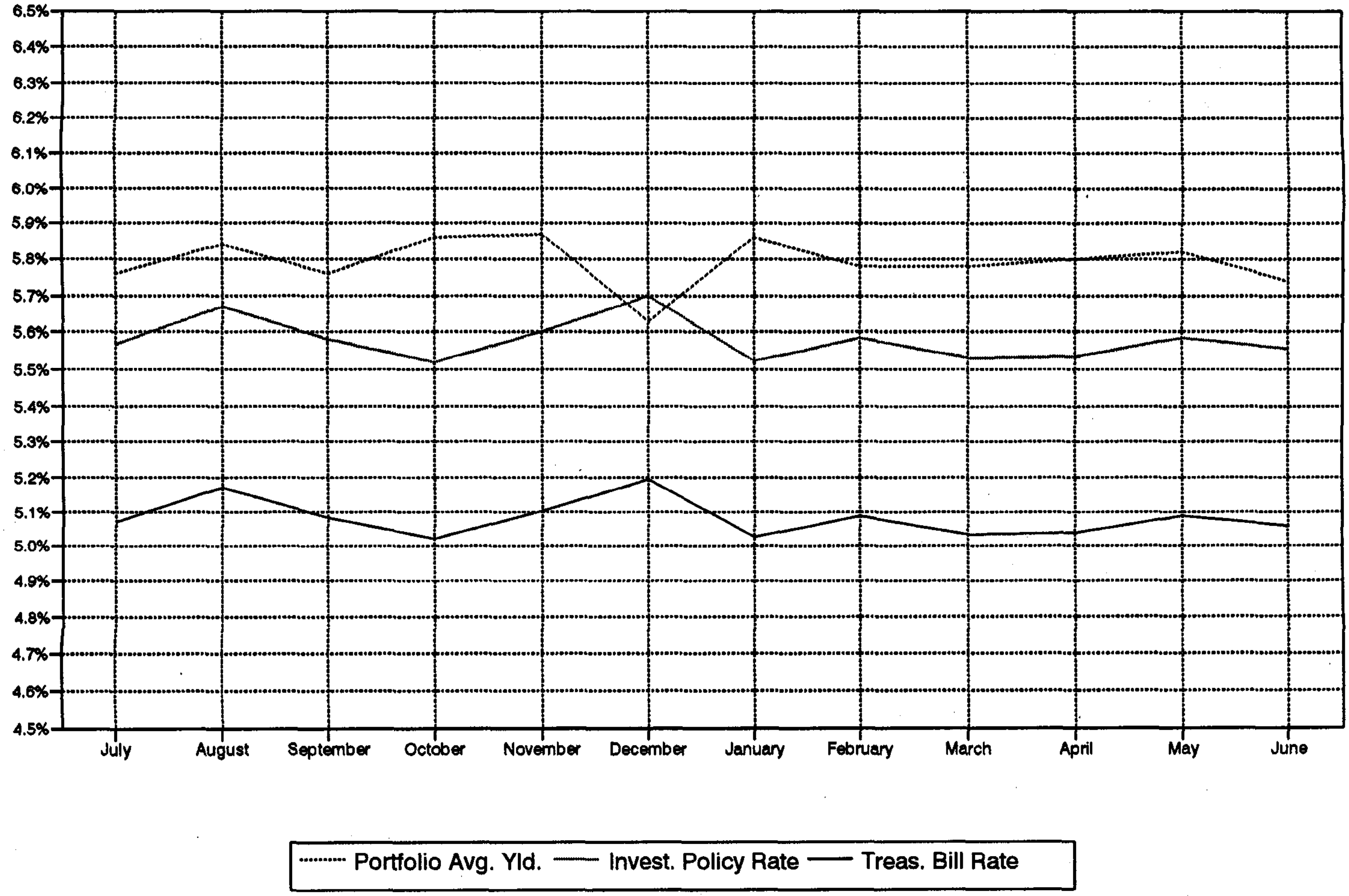
	January	February	March	Third Quarter Average	April	May	June	Fourth Quarter Average	Fiscal Y-T-D Average
Par Value (000's)	70,865	70,740	71,619	71,075	77,412	77,651	78,091	77,718	71,240
Total Cost (000's)	70,781	70,655	71,526	70,988	77,300	77,534	77,968	77,601	71,132
Average Yield	5.86%	5.78%	5.78%	5.81%	5.80%	5.82%	5.74%	5.79%	5.79%
Average	189	211	228	209	268	266	266	267	245

CHART E
RATINGS OF 1997-98 PURCHASES

Security Purchased	Purchase	Par	Rating	Maturity
Standard Credit MT ABS	06/30/98	3,000,000	AAA	01/07/99
Fed. National Mort'g. Assoc.	06/30/98	2,000,000	AAA	06/30/2000
GE Capital Med Term Note	05/01/98	2,000,000	AAA	04/28/2000
GE Capital Med Term Note	04/29/98	2,000,000	AAA	05/01/2000
Federal Home Loan Bank	04/20/98	2,000,000	AAA	04/20/2000
American Express MT ABS	04/07/98	2,000,000	AAA	09/15/2000
GE Capital Med Term Note	04/07/98	2,000,000	AAA	03/30/2000
Fed. National Mort'g. Assoc.	03/27/98	2,000,000	AAA	03/29/2000
Student Loan Mkt'g. Assoc.	02/27/98	2,000,000	AAA	02/25/2000
Student Loan Mkt'g. Assoc.	03/30/98	2,000,000	AAA	03/03/2000
Fed. National Mort'g. Assoc.	02/24/98	2,000,000	AAA	01/13/2000
Federal Home Loan Bank	02/27/98	2,000,000	AAA	02/28/2000
Fed. National Mort'g. Assoc.	12/19/97	1,750,000	AAA	09/09/98
Federal Home Loan Bank	12/30/97	2,000,000	AAA	12/30/99
Fed. National Mort'g. Assoc.	07/31/97	2,000,000	AAA	07/31/98
Federal Home Loan Bank	08/12/97	2,000,000	AAA	11/12/99
Standard Credit MT ABS	07/16/97	2,000,000	AAA	02/07/99
Standard Credit MT ABS	07/10/97	2,500,000	AAA	02/07/99
# purchased/owned %		Total $	% $	
18 94.74%		$37,250,000	94.90%	
Societe General YCD	10/27/97	2,000,000	AA1/AA	10/27/98
# purchased/owned %		Total $	% $	
1 5.26%		$2,000,000	5.10%	
Grand Total				
19		$39,250,000		

CHART F

INVESTMENT PERFORMANCE



GLOSSARY

INVESTMENT TERMS

BASIS POINT: One one-hundredth of 1% or .01%. It is the smallest measure used in quoting yields (earnings) on bonds and notes.

BROKER: A middleman who brings buyers and sellers together and handles their orders, generally charging a commission for his services. The broker does not own or take a position in the security.

COLLATERAL: Securities pledged by a financial or investment institution to secure deposits or transactions of an investor.

CURRENT YIELD: The annual interest earning on a security divided by the current market value.

DISCOUNT: The difference between the current market value of a security and its face value.

EFFECTIVE RATE: The annual interest earning on a security divided by its original purchase price.

L.A.I.F.: The Local Agency Investment Fund. This is the fund in which the State of California pools its investments and the investments of California public agencies which participate in L.A.I.F. An agency participates by depositing funds in the State pool for investment by the State.

MARKET VALUE: The price at which a security is trading and at which it could presumably be purchased and sold.

PAR: (1) Price at 100% of face value. (2) The principal amount at which the issuer of the security contracts to redeem it at maturity.

PORTFOLIO: Collection of securities held by an investor.

PREMIUM: (1) The amount by which the price at which an issue is trading exceeds the issue's par value. (2) The amount which must be paid in excess of par to call or refund an issue before maturity.

RATING AGENCY: A firm which evaluates security issuers' investment and credit risk. The agencies include Fitch Investor's Service, Moody's Investment Service and Standard & Poor's Corporation.

RETURN: Profit on a security or capital investment usually expressed as an annual percentage rate.

YIELD: Return on an investor's capital investment. Two specific types of yield are defined under "Current Yield" and "Yield to Maturity."

YIELD TO MATURITY: The rate of return derived from a security if held to maturity when both interest payments and the investor's principal premium or discount on the security are taken into account.

TYPES OF INVESTMENT

BANKER'S ACCEPTANCE (BA): A draft or a bill accepted by a bank or trust company to finance trade. It is issued on a discounted basis and offers three levels of investor protection.

CERTIFICATE OF DEPOSIT(CD): Receipt for funds deposited in a bank for a specific period for a specified rate of interest. The CD may be secured or made safe with federal insurance or by collateralization.

TYPES OF CD: (1) Non-negotiable CD: A CD that cannot be sold or cashed without penalty before maturity. Collateralized CDs are non-negotiable. (2) Negotiable CD: A large denomination CD issued by large banks and traded on the open market. They are not collateralized but are rated in terms of the financial security of their issuer.

COMMERCIAL PAPER: Short-term corporate IOUs, generally due in less than a year and sold at a discount from face value.

GOVERNMENTS: As used in the United States, all types of security issues of the federal government and federal agencies.

MEDIUM TERM NOTES (MTN): Corporate promissory notes of 9-month to 15-year duration sold through dealers on a continuously-offered basis. Like certificates of deposit, MTN's can be either collateralized or unsecured. Issuers include banks and savings and loans, insurance companies and corporations.

REPURCHASE AGREEMENT (RP OR REPO): The purchase of portfolio securities by an investor with a simultaneous agreement to resell the securities back to the seller on a specific future date, at the original purchase price, plus a negotiated interest payment. This transaction may be secured or made safe with collateralization.

Attachment B

STATEMENT OF INVESTMENT POLICY

November 19, 1996

with amendments of October 28, 1997

EXHIBIT "B" TO RESOLUTION NO. 98-XXX

CITY OF HAYWARD

STATEMENT OF INVESTMENT POLICY

I. Introduction

The purpose of this document is to identify various policies and procedures that enhance opportunities for a prudent and systematic investment process. The initial step toward a prudent investment policy is to organize and formalize investment-related activities. Related activities which comprise good cash management include accurate cash projection, the expeditious collection of revenue, the control of disbursements, cost-effective banking relations, and short-term borrowing program which coordinates working capital requirements and investment opportunity. In concert with these requirements are the many facets of an appropriate and secure short-term investment program.

II. Scope

It is intended that this policy cover all short-term operating funds and investment activities under the direct authority of the City. These funds are described in the City's annual financial report and include:

- General Fund
- Special Revenue Funds
- Capital Projects Funds
- Enterprise Funds
- Internal Service Funds
- Fiduciary Funds
- Redevelopment Agency Funds
- Housing Finance Agency Funds
- Industrial Development Authority Funds

This investment policy applies to all transactions involving the financial assets and related activity of the foregoing funds.

Specifically excluded from this policy are the assets and investments comprising the Deferred Compensation Fund. Investment of these monies are directed by each employee in accordance with the rules of the Deferred Compensation Plan of the City.

Also excluded are employer and employee deposits in the PERS Fund; and employer and employee deposits in the PARS Fund.

Monies held by a trustee or fiscal agent and pledged to the payment or security of bonds or other indebtedness, or obligations under a lease, installment sale, or other agreement of the City, or certificates of participation in those bonds, indebtedness, or lease installment sale, or other agreements may be invested in accordance with the ordinance, resolution, indenture or agreement approved by the City Council which govern the issuance of those bonds, or lease installment sale, or other agreement, rather than this Statement of Investment Policy.

III. <u>Objectives</u>

A. Safety of a principal is the foremost objective of the City, followed by liquidity and yield. Each investment transaction shall seek to first ensure that capital losses are avoided, whether they be from securities defaults or erosion of market value.

B. Investment decisions should not incur unreasonable investment risks in order to obtain current investment income.

C. The City's investment portfolio will remain sufficiently liquid to enable the City to meet all operating requirements which might be reasonably anticipated. This need for investment liquidity may be tempered to the extent that the City is able to issue short-term notes to meet its operating requirements.

D. The investment portfolio shall be managed to attain a market-average rate of return throughout budgetary and economic cycles, taking into account the City's investment risk constraints and cash flow requirements, and state and local law, ordinances or resolutions that restrict the placement of short-term funds.

E. The investment portfolio shall be managed with the objective of regularly exceeding by 50 basis points, the average of three-month and six-month U.S. Treasury Bill rates for the equivalent period. These indices are considered benchmarks for riskless investment transactions and therefore comprise a minimum standard for the portfolio's rate of return. The investment program shall seek to augment returns above this threshold, consistent with risk limitations identified herein and prudent investment principles.

F. The City's investment portfolio will be diversified to avoid incurring unreasonable and avoidable risks associated with concentrating investments in specific security types or in individual financial institutions.

G. While the City will not make investments for the purpose of trading or speculation as the dominant criterion, the Director of Finance shall seek to enhance total portfolio return by means of active portfolio management. The prohibition of speculative investments precludes pursuit of gain or profit through unusual risk and precludes investments primarily directed at gains or profits from conjectural fluctuations in market prices. However, as long as the original investments can be justified by their ordinary earning power, trading in response to changes in market value or market direction is a requirement of active portfolio management.

H. The City adheres to the guidance provided by the prudent investor standard which obligates a fiduciary to ensure that investments shall be made with the exercise of that degree of judgment and care, under circumstances then prevailing, which a prudent person acting in a like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the agency.

I. All participants in the investment process shall act responsibly as custodians of the public trust. Investment officials shall recognize that the investment portfolio is subject to public review and evaluation. The overall program shall be designed and managed with a degree of professionalism that is worthy of the public trust. Nevertheless, in a diversified portfolio, it must be recognized that occasional measured losses are inevitable, and must be considered within the context of the overall portfolio's investment return, provided that adequate diversification has been implemented.

IV. <u>Delegation of Authority</u>

In accordance with Section 53607 of the California Government Code, the responsibility for conducting the City's investment program is delegated to the Director of Finance, who has established written procedures for the operation of the investment program, consistent with this investment policy, which also govern delegation of authority for all investment activities.

V. Investment Advisory Committee

The City Manager will appoint an investment advisory committee for the purpose of overseeing the implementation of the City's investment program and assuring it is consistent with the investment policy as approved by the Council. The advisory committee shall consist of the Assistant City Manager, the City Attorney, a representative of California State University at Hayward, a member of the financial community, and two department heads chosen by the City Manager.

The investment advisory committee shall meet at least quarterly to determine general strategies and to monitor results. The committee shall include in its deliberations such topics as: economic outlook, portfolio diversification and maturity structure, potential risks to the City's funds, approval of authorized financial institutions, and the target rate of return on the investment portfolio. Written investment procedures must be approved by the investment advisory committee.

VI. Reporting: Interim and Annual

Monthly

Within 30 days of the end of each month the Director of Finance shall submit a monthly investment report to the City Manager and the City Council and shall provide copies to the Chairman and Members of the Investment Advisory Committee. Graphs, charts or schedules of the monthly report shall itemize the month's investment purchases, sales and maturities and indicate their effect on portfolio value, both individually and by investment category; itemize all investments and deposits in the portfolio by investment or deposit category, providing essential identifying characteristics for each investment or deposit; indicate the percentage of the portfolio represented by each investment and by each investment category; show all par values, market values and costs at time of purchase, together with each item's coupon or discount rate and current earning rate; show the average earning rate for the portfolio together with daily earnings and monthly earnings by item, by category and in total; indicate distribution of the portfolio by maturity category
and from 0-29 days to two to four years; and provide other relevant detail to accomplish exemplary disclosure of investment activity and portfolio status.

The text of the monthly report shall highlight key aspects of information contained in investment report schedules; inform readers of economic conditions affecting the portfolio, recent investment performance and future investment strategy; disclose any perceived threats to portfolio quality, security or liquidity; compare the average portfolio investment yield with the portfolio target yield defined in Section III E above; incorporate by reference the most recent report received by the City from the State of California Local Agency Investment Fund (LAIF) detailing the investment types, issuers, maturity dates, par values and investment amounts comprising the pooled monies held by the state; and provide information as to the source of the market valuation data provided in the report. As use of the report discloses ways in which communication can be improved, the report will be enhanced with a view to achieving optimum disclosure of investment activity and portfolio status.

Annual

Within 60 days of the end of the fiscal year the Director of Finance shall present a comprehensive annual report on the investment program and investment activity. This report shall be presented to the Investment Advisory Committee. The annual report shall include twelve-month and separate quarterly comparisons of return, shall suggest policies and improvements that might enhance the investment program, and include an investment plan for the ensuing fiscal year.

In conjunction with its review of the annual investment report, the Investment Advisory committee shall review and reaffirm the Statement of Investment Policy of the City, whether or not specific policy modifications are suggested as part of the annual report.

Following the annual review of the Statement of Investment Policy by the Investment Advisory Committee, the Investment Policy shall be submitted to the City Council together with any changes recommended by the Advisory Committee. The City Council shall consider any such recommended changes and annually reaffirm the Statement of Investment Policy at a public meeting of the City Council.

VII. Investment Instruments

Investment instrument authorized for purchase by the City include:

A. U.S. Treasury, agency and instrumentality obligations maturing within four years;

B. certificates of deposit;

C. prime bankers' acceptances with maturities less than 270 days, which are eligible for purchase by the Federal Reserve System, and are issued by the top 50 banks in the world, or any qualified depository in the State of California with a 4.5 percent equity to asset ratio. Purchases from any one bank may not exceed 30 percent of the City's investment portfolio;

D. prime commercial paper;

E. medium term corporate notes with

(a) a maximum maturity of two years issued by corporations doing business in the United States which are rated "A" or its equivalent or better byone or more of the four following national rating services: Moody's, Standard and Poor's, Fitch's or Keefe's;

(b) a maximum maturity of three years, A+ or its equivalent or better; or

(c) a maximum maturity of four years, AA or its equivalent or better.

F. State of California Local Agency Investment Fund;

G. County agency investment fund;

H. repurchase agreements; and

I. reverse repurchase agreements for cash flow purposes when authorized by the City Council and

(a) with securities owned and previously paid for for a minimum of 30 days prior to the settlement of the reverse repurchase agreement

(b) shall not exceed 20% of the portfolio

J. mutual funds meeting the requirements of Section No. 53601(k) of the State Government Code, provided that use of mutual funds shall be limited to bond proceeds for which the City Treasurer finds a mutual fund's accounting methods particularly suited to the accounting requirements of the bond issue and helpful with arbitrage calculations.

K. Asset-backed corporate notes of the following characteristics:

(a) Minimum rating agency rating of the issuer: A, its equivalent, or better

(b) Minimum rating agency rating of the asset-backed securities themselves: AA, its equivalent, or better.

(c) Maximum percentage of the portfolio permissible for asset-backed securities: 20 percent. However, because medium term notes and asset-backed securities are both corporate securities, and because the 30 percent ceiling on medium term notes and 20 percent ceiling on asset-backed securities could result in an undue concentration of investments in corporate securities, the combined share of the portfolio occupied by the two classes of corporate securities shall not exceed 40 percent.

(d) Mortgage-backed corporate notes shall not be invested in.

(e) Maturity limits: "Bullet" maturity, four years; "Stated Final" maturity, five years.

L. The City shall not invest any funds in any security that could result in zero interest accrual if held to maturity. This limitation shall not apply to investments in shares of beneficial interest issued by diversified management companies as provided for in Section VII.J., above; or to such prohibited investments held at the time this section is adopted.

M. The City shall not invest any funds in inverse floaters, range notes, or interest only strips that are derived from a pool of mortgages.

N. The limitations set forth in Section VII. L. and M., above shall not apply to investments in shares of beneficial interest issued by diversified management companies as provided for in Section VII. J., above; or to such prohibited investments held in the portfolio at the time this section is adopted.

VIII. <u>Investment Terms and Conditions</u>

A. The following terms and conditions shall apply to the use of repurchase agreements:

1. Securities purchased under the repurchase agreement shall be limited to the securities and qualifications listed above.

2. Securities shall be marked-to-market daily, and shall be maintained at a value equal to or greater than the cash investment.

3. At the time of purchase the market value of the securities shall be in excess of the cash investment.

4. All securities purchased under a repurchase agreement shall be held by a third-party custodian or safekeeping agent. Transfer of underlying securities to a counterparty bank's customer book entry account may be used for book entry delivery, and a counterparty bank's trust department or safekeeping department

may also be used for physical delivery of the underlying security.

5. The seller of repurchase securities shall not be entitled to substitute securities, except as authorized by the City. New or substitute securities should be reasonably identical to the original securities in terms of maturity, yield, quality, and liquidity.

6. "Retail" repurchase agreements shall not be authorized for purchase.

7. As soon as possible a master repurchase agreement shall be executed between the City and all trading partners.

B. The following terms and conditions shall apply to the use or commercial paper:

1. Maturities shall be limited to 180 days or less.

2. Purchases must be of the highest letter and numerical rating as provided for by Moody's or Standard and Poor's rating services.

3. Purchases must be limited to corporations organized and operating within the United States, having total assets in excess of five hundred million dollars, and having an "A," its equivalent or higher rating for the issuer's debentures, other than commercial paper (as provided for by Moody's or Standard and Poor's rating service).

4. Purchases may not represent more than 10% of the outstanding paper of an issuing corporation.

C. The following terms and conditions shall apply to the use of negotiable certificates of deposit:

1. Certificates with maturities greater than six months through one year shall have an A-2/P-2 rating or its equivalent or better as provided for by one of the four following national rating services: Moody's, Standard and Poor's, Fitch's or Keefe's.

2. Certificates with maturities greater than one year shall have the following, equivalent or higher ratings: one through two years, A; two through three years, A+; three through four years, AA.

IX. In the event that a financial institution or depository receives a Standard and

Poor's, Moody's, Fitch or Keefe rating equal to or lower than Standard and Poor's rating of BBB, the Finance Director promptly shall make and implement an informed decision on whether to sell, withdraw from deposit or retain any security or deposit in the City portfolio issued or held by such affected financial institution or depository. The Finance Director may consult the Investment Advisory Committee on the action to be taken and shall advise its Chairman and Member of the final disposition of the matter either by memorandum or at the next Investment Advisory Committee meeting. If the meeting is scheduled more than a month after action is taken, the communication of disposition will be by memorandum.

X. Prudence

The standard of prudence to be used by investment officers shall be the prudent investor standard and shall be applied in the context of managing an overall portfolio. Investment officers acting in accordance with written procedures and exercising due diligence shall be relieved or personal responsibility for an individual security's credit risk or market price changes, provided that deviations from expectation are reported in a timely fashion, and appropriate action is taken to control adverse developments.

XI. Internal Controls

The Director of Finance shall establish a system of internal controls, which shall be documented in writing. The controls shall be designed to prevent losses of public funds arising from fraud, employee error, misrepresentation by third parties, unanticipated changes in financial markets, or imprudent actions by employees and officers of the City. Controls deemed most important include: control of collusion, separation of duties, separating transaction authority from accounting and recordkeeping, custodial safekeeping, clear delegation of authority, specific limitations regarding securities losses and remedial action, written confirmation of telephone transactions, minimizing the number of authorized investment officials, documentation of transactions and strategies, and ethical standards.

XII. Banks and Securities Dealers: Selection

In selecting financial institutions for the deposit or investment of City funds, the Director of Finance shall consider the creditworthiness of institutions. The Director of Finance shall continue to monitor financial institutions' credit characteristics and financial history throughout the period in which City funds are deposited or invested.

Effective October 14, 1987, the City shall be prohibited from investing funds with any person which is knowingly or intentionally engaged in the development or production of nuclear weapons. Person is defined as any person, private corporation, institution or other entity, which is within the jurisdiction of the City of Hayward.

The Investment Advisory Committee shall approve all financial institutions from which securities are purchased or sold.

Only primary government securities dealers that report to the New York Federal Reserve shall be used for the purchase of repurchase agreements. (It is acknowledged that inclusion on the primary dealer listing of the Federal Reserve Bank of New York is not a guarantee of creditworthiness.)

XIII. Maturity

The City shall not invest in instruments whose maturities exceed four years at the time of purchase. Instruments with maturities greater than two years shall be limited to (1) U.S. Treasury and agency obligations; (2) medium term notes rated "A" or its equivalent or better by at least one of the four national rating services identified above; (3) certificates of deposit rated "A", its equivalent or better by at least one of the four national rating services identified above; and (4) asset-backed notes as regards the "bullet" maturity, provided the "stated final" maturity is not more than five years. The average maturity of the City's short-term portfolio shall not exceed one year.

It is the intent that investments shall be managed in such a way that any market price losses resulting from interest-rate volatility would be offset by coupon income and current income received from the balance of the portfolio during a twelve-month period.

XIV. Diversification

It is City policy to diversify the investment portfolio in order to reduce the risk of loss resulting from over concentration of assets in a specific maturity, a specific issuer, or a specific class of securities. The following strategies and constraints shall apply:

A. Portfolio maturities shall be staggered in a way that avoids undue concentration of assets in a specific maturity sector. Maturities shall be selected which provide for stability of income and reasonable liquidity.

B. Concern for liquidity shall be insured through practices that include covering the next vendor disbursement date and payroll date through maturing investments of U.S. Treasury bills.

C. Risks of market price volatility shall be controlled through maturity diversification such that aggregate price losses on instruments with maturities exceeding one year shall not be greater than coupon interest and investment income received from the balance of the portfolio.

D. Specific diversification limitation shall be imposed on the portfolio as follows:

1. No more than 40% of the portfolio may be invested beyond twelve months, and the average maturity of the portfolio shall not exceed 400 calendar days.

2. Except for deposits in the Local Agency Investment Fund, instruments of the U.S. government or federal agencies fully backed by the U.S. government, and fully collateralized certificates of deposit or fully collateralized medium term notes, no more than 20% of the overall portfolio may be invested in the securities of a single financial institution.

3. The maximum proportion of the total portfolio that shall be placed at any one time in each of the categories of investment are as follows:

   (a) Thirty (30) percent in negotiable certificates of deposit,

   (b) Forty (40) percent in banker's acceptances,

   (c) Thirty (30) percent in medium term notes,

   (d) Twenty-five (25) percent in any other obligation (with the exception of commercial paper) that does not bear the full faith and credit of the United States government or which is not fully collateralized or insured,

   (e) Twenty (20) percent in asset-backed securities provided, however, that medium term notes and asset-backed securities in combination do not exceed forty (40) percent of the portfolio.

4. No more than 15% of the portfolio may be invested through the County Treasurer in any agency investment fund which the County may establish.

5. No more than 15% or the portfolio may be invested in prime commercial paper. However, if the dollar-weighted average

maturity of the entire portfolio does not exceed 31 days, an additional 15% may be invested in prime commercial paper.

6. In accordance with California statutes, City deposits including collateralized certificates of deposit shall not exceed the total paid-up capital (to include capital notes and debentures) and surplus of any depository bank, or the total of the net worth of any savings and loan association.

XV. Risk Tolerance

The City recognizes that investment risks can result from issuer defaults, market price changes or various technical complications leading to temporary illiquidity. Portfolio diversification is employed as a way to control risk. Investment managers are expected to display prudence in the selection of securities, as a way to minimize default risk. No individual investment transaction shall be undertaken which jeopardizes the total capital position of the overall portfolio. The Director of Finance shall periodically establish guidelines and strategies to control risks of default, market price changes and illiquidity. All investment reports shall specifically address whether current investment results have been affected by any of the foregoing risks, and shall explain what actions investment officials have taken to control or correct for such risks.

In addition to these general policy considerations, the following specific policies will be strictly observed:

A. All investment funds will be placed directly with qualified financial institutions. The City will not deposit or invest funds through third parties or money brokers.

B. All transactions will be executed on a delivery versus payment basis.

C. The City will not enter into reverse repurchase agreements other than for cash flow requirements; nor shall it trade in options on future contracts unless, upon recommendation by the Investment Advisory Committee, such transactions are specifically authorized by the City Council.

D. A competitive bid process, utilizing a minimum of three financial institutions deemed eligible by the Investment Advisory Committee, will be used to place all investment purchases. Based on a quarterly evaluation, securities dealers, banks and other financial institutions will be dropped or continued on the eligibility list. The following criteria will be used in the quarterly evaluation:

1. number of transactions competitively won
2. prompt and accurate confirmation of transactions
3. efficient securities delivery
4. accurate market information account servicing

E. The Finance Director shall designate an official to manage investments and designate a second official to perform investment management during absences of the primary designee. The Finance Director shall insure that competent investment management is maintained and shall insure that, if both designated investment officials are replaced or are simultaneously absent, any temporary replacement(s) shall be closely supervised, indoctrinated in the requirements of this Statement of Investment Policy, and given written investment procedures regulating the authority to invest in maturities beyond six months by means of appropriate controls and restraining requirements.

F. In order to assist in identifying "qualified financial institutions," the Finance Director shall forward copies of the City's Investment Policy to those financial institutions with which the City is interested in doing business and require written acknowledgement of the Policy.

XVI. Safekeeping and Custody

To protect against potential fraud and embezzlement, the assets of the City shall be held in the City's vault or secured through third-party custody and safekeeping procedures. The investment official shall be bonded to protect the public against possible embezzlement and malfeasance. Safekeeping

procedures shall be reviewed annually by an independent auditor. The auditor may conduct surprise audits of safekeeping and custodial procedures.

XVII. Investment Policy Adoption

The City's investment policy shall be formally reviewed and approved by the Investment Advisory Committee, not more than 120 days after the beginning of each fiscal year; and, thereafter shall be reviewed and approved by the City Council at a public meeting.

JB 11/10/98

HAYWARD CITY COUNCIL

RESOLUTION NO. _____

Introduced by Council Member _______

RESOLUTION ACCEPTING THE ANNUAL REPORT ON INVESTMENT PROGRAM AND ACTIVITY FOR THE CITY OF HAYWARD, AFFIRMING THE STATEMENT OF INVESTMENT POLICY AND RENEWING THE DELEGATION OF AUTHORITY TO MAKE INVESTMENTS TO THE DIRECTOR OF FINANCE

WHEREAS, by Resolution No. 85-252 C.S. dated August 6, 1985, the City Council adopted a Statement of Investment Policy for the City of Hayward; and

WHEREAS, the Statement of Investment Policy requires the Director of Finance to submit an annual report and make recommendations for amendments to the investment program; and

WHEREAS, the Director of Finance has submitted his annual report to the City Council and recommendations for amendments of the investment program to the City Council.

NOW, THEREFORE, BE IT RESOLVED by the City Council of the City of Hayward that that certain report entitled "Annual Report on Investment Program and Activity for the Fiscal Year Ending June 30, 1998," attached hereto as Exhibit "A" and incorporated herein, is hereby accepted as the annual report required by the investment policy of the City of Hayward.

BE IT FURTHER RESOLVED that the Statement of Investment Policy is hereby affirmed, and that the authority of the Director of Finance, or his or her designee, to make investments pursuant to the Policy is hereby renewed.

IN COUNCIL, HAYWARD, CALIFORNIA ________, 1998

ADOPTED BY THE FOLLOWING VOTE:

AYES:

NOES:

ABSTAIN:

ABSENT:

ATTEST:____________________
City Clerk of the City of Hayward

APPROVED AS TO FORM:

____
City Attorney of the City of Hayward